Commodity Trends

Desjardins Economic Studies
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Gold stole the show in the first quarter

After some very hard years, sentiment about commodities has been a little more positive since the start of 2016. Capitalizing on investor concern at the start of the year and the increasingly extreme monetary policies instituted by several central banks, gold has done especially well, shooting up more than 16% in the first three months of 2016, the biggest quarterly increase in 30 years (graph 1). After tumbling to a 12-year low in mid-February, oil prices have also done well lately, even climbing back to about US$40 a barrel.

However, we must not read the recent comeback of some prices as a return of the crazy years seen at the start of the millennium. The rise is not general and some commodity price indexes even retreated in the first quarter (graph 2), reflecting the sharp drop by natural gas prices among other factors. Overall, commodity prices remain depressed and the conditions do not yet seem to be in place for a sustained rise, with global economic growth still too subdued at the start of 2016. The major gains made by precious metal prices and, to a lesser extent, oil prices largely reflect financial factors that could quickly reverse, especially when the Federal Reserve will start to signal that a second key rate increase is imminent. Caution is thus in order in the near term, although we still expect resource prices to come up gradually over the medium term.

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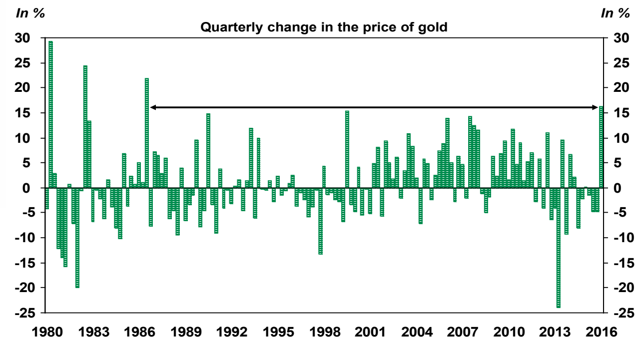
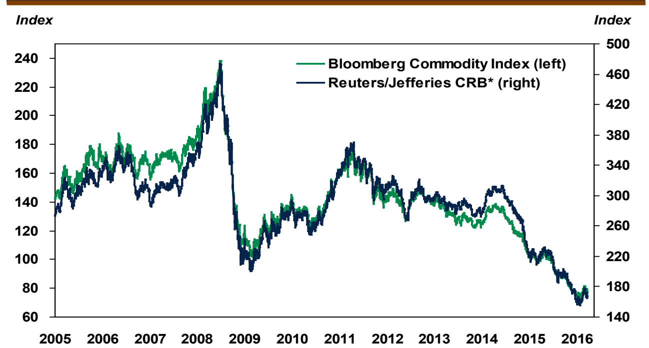
Graph 1 – You have to look back to 1986 to find a better quarter for the price of gold



Sources: Datastream and Desjardins, Economic Studies

Graph 2 – Commodity price indexes are still depressed



* Commodity Research Bureau.
Sources: Datastream and Desjardins, Economic Studies

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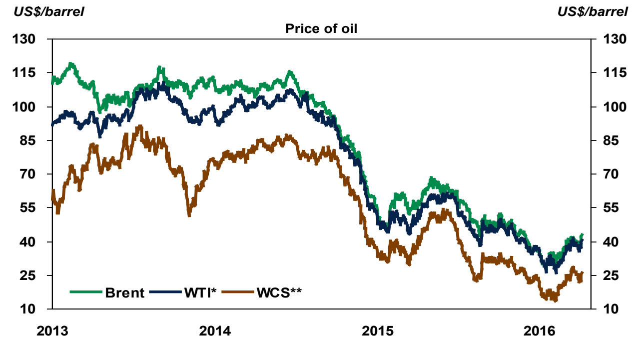
ENERGY

Oil prices could oscillate around current levels for a while

OIL

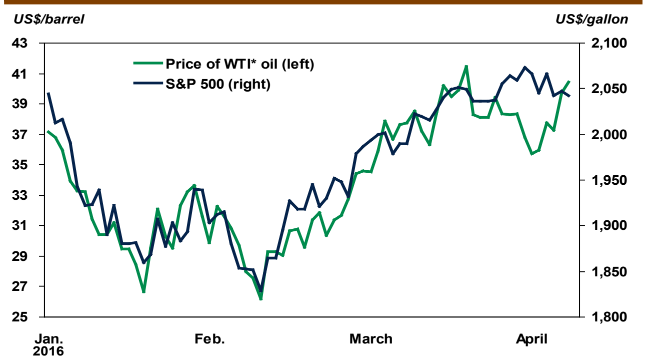
- Like the stock markets, oil prices fluctuated wildly in the first quarter. The year 2016 began with an extremely negative climate; fears of another financial crisis or global recession took WTI (West Texas Intermediate) prices down to US$26 a barrel on February 11, a 12-year low. Benefiting from the upswing in optimism that followed due to such things as vigorous measures from the European Central Bank, WTI rebounded to just above US$40 a barrel in mid-March, then recently slid back a bit. Brent and WCS (Western Canada Select) prices followed similar trends (graph 3).
- A lot of ink is being spilt over the very close link between WTI prices and the level of the S&P 500 (graph 4), with some seeing it as a sign that a rise by oil prices was now good news for business and the U.S. economy. We think, however, that the stock markets and oil both tend to react to the same news on the state of the global economy, as well as to investors' mood changes. In recent weeks some divergence has emerged, which could be a sign that fundamental factors are starting to have more influence over crude prices.
- Fundamentally, talks between some member nations of the Organization of Petroleum Exporting Countries (OPEC) and Russia continue to get attention. Note that these countries are no longer talking about cutting their output, but rather about freezing it at current levels. A meeting on this matter, to be held April 17, will certainly yield some volatility in the oil market. In our opinion, such an agreement will however have no impact on crude prices over the medium range. Even without an agreement, nothing points to an increase in production by Russia or most OPEC nations. Iran is the exception, but no agreement will persuade it to keep its production where it is now that trade sanctions have been lifted. Iran's output has already gone up by about 400,000 barrels a day since the start of 2016 and a similar increase is anticipated by year's end (graph 5). As for Iraq, production seems to have crested following last year's impressive surge. Its evolution will now be more dependent on domestic conditions than international agreements.
- In the near term, movement by oil prices will primarily depend on the pace at which U.S. output falls and the strength of global demand. The outlook there has not changed much over the months; we still expect the oil supply and demand to be back at equilibrium toward the end of 2016. The huge drop in oil sector investment, however, is a substantial upside risk for prices over the medium range. Wood Mackenzie estimates that the plunge of oil prices will lead to a total of US$500B in investments being abandoned or deferred, with a major impact on the oil supply over the medium term. The Canadian situation provides an apt illustration of this phenomenon (graph 6 on page 3): Canadian output will keep increasing this year as

Graph 3 – Oil prices have rallied



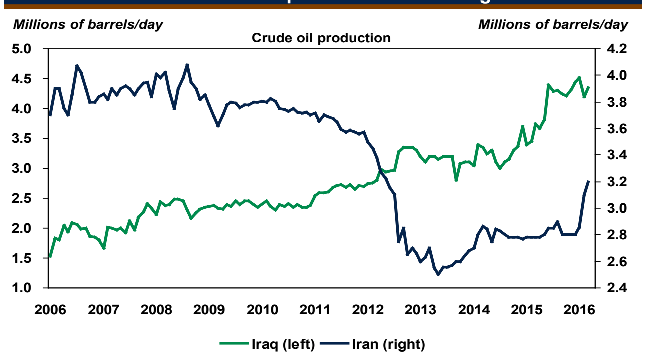
* West Texas Intermediate; ** Western Canada Select.
Sources: Datastream, Bloomberg and Desjardins, Economic Studies

Graph 4 – Until just recently, the stock market and oil prices were moving in tandem



* West Texas Intermediate.
Sources: Datastream and Desjardins, Economic Studies

Graph 5 – Iran's production has started to rebound, but that of Iraq seems to be cresting



Sources: Bloomberg and Desjardins, Economic Studies projects started a few years ago come on line. The lack of new investment, however, could make Canadian production crest over the medium term.[1]

GASOLINE

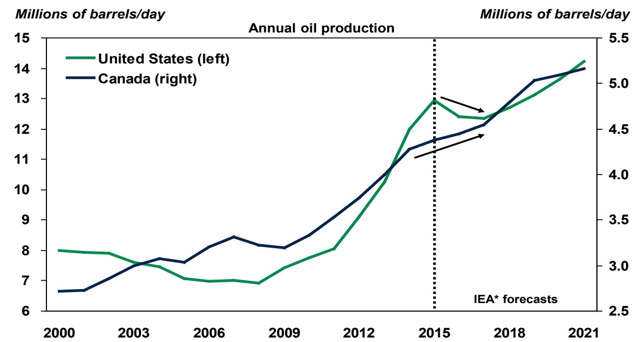
- Rebounding oil prices has pushed gas prices up a little. In the United States, the average price for regular gas has gone from less than US$1.75 a gallon at the start of February to just over US$2 recently (graph 7). Canadian gas prices are up about US$0.10 a litre from their February low. Favourable seasonal factors and stabilizing oil prices could make gas prices tick down over the months to come. Tesla's launch of a more economical electric car is raising interesting questions about long-term gas demand. However, the composition of the automobile fleet will change very gradually.

NATURAL GAS

- After holding above US$2/MMBTU (Million British Thermal Units) until mid-February, natural gas prices fell again, dropping to US$1.49/MMBTU at the start of March, slightly below the cyclical low reached just before Christmas. The very mild winter, which limited demand, certainly has something to do with the low gas prices. The U.S. Department of Energy recently wrote that, to date, the temperature was above normal in 18 of the 21 weeks of the 2015–2016 heating season. Natural gas prices have come up to nearly US$2 since then, reflecting a fairly chilly early spring. The extremely large inventories (graph 8) suggest, however, that prices will stay very low.

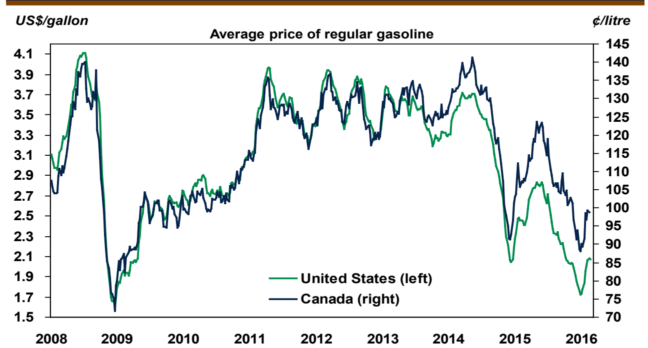
Forecasts: An ongoing surplus in the oil market and very large global inventories do not suggest that oil prices will go up further in the near future. After oscillating around current levels for a while, WTI prices should start to strengthen in the second half of 2016, ending the year at around US$50 a barrel, as the global market should be back in equilibrium. Natural gas prices should also remain very low in the near future, then end the year at more normal levels.

Graph 6 – Canadian oil production will keep increasing in the short term, but could stagnate after that



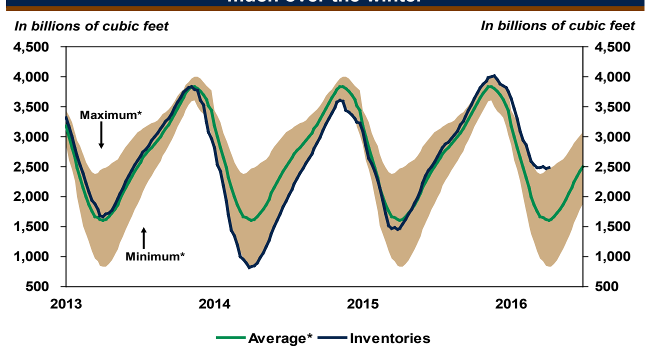
* International Energy Agency.
Sources: International Energy Agency and Desjardins, Economic Studies

Graph 7 – Gasoline prices have crept back up a bit



Sources: Datastream, Natural Resources Canada and Desjardins, Economic Studies

Graph 8 – U.S. natural gas inventories did not decrease much over the winter



* From 2011 to 2015.
Sources: Energy Information Administration and Desjardins, Economic Studies

[1] Desjardins, Economic Studies, *Economic News*, "Canadian oil production should keep rising," March 14, 2016, www.desjardins.com/ressources/pdf/nf160314-e.pdf?resVer=1457963728000.

BASE METALS

Some encouraging signals from manufacturing

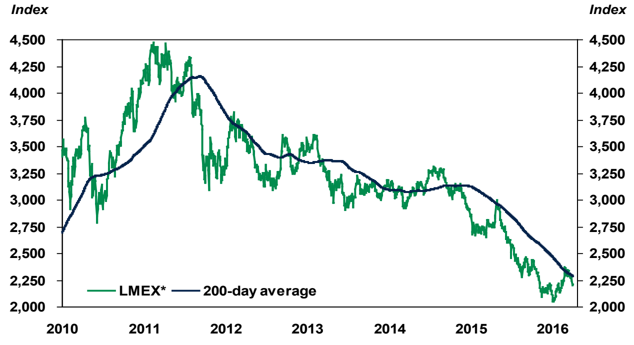
Overall, the first quarter of 2016 has been fairly good for industrial metals. After showing some resilience at the start of the year despite the surge in investor anxiety, base metal prices have started trending up, capitalizing on the U.S. dollar's weakness and renewed investor confidence. The LME (London Metal Exchange) index hit 2,369 at the beginning of March, up 7.5% from the start of the year. However, the last few weeks have not been as good, with disappointing international trade data from China raising renewed concern (graph 9).

The global economy's modest growth is a big obstacle to a strong metal price comeback. The latest disappointment came from the U.S. economy, which seems to be heading for very subdued economic growth in Q1 2016. The U.S. manufacturing sector is nevertheless starting to send out more encouraging signals: the ISM manufacturing index is back above 50, the level that signals an expansion of the manufacturing sector, and some of the major sub-components have even surged (graph 10). In China, too, manufacturing is sending better signals and the government's stimulus efforts should sustain demand for metals.

ALUMINUM

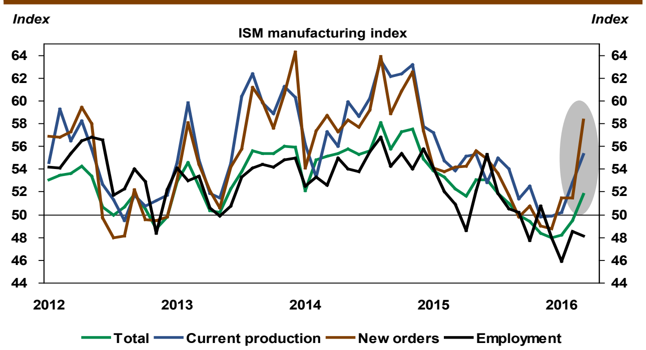
- After a very tough 2015, aluminium prices did well in early 2016, even going above US$1,600 a tonne in early March. Recently, however, they dropped back to around US$1,500 a tonne (graph 11). Beyond financial factors and the overall trend for metal prices, aluminium's comeback got a big hand from an agreement to cut Chinese production at the end of 2015. The metal's price has, however, rebounded more than 20% from its low in China, which is high enough to make about 50% of the country's aluminium production capacity profitable. Recently, therefore, some Chinese producers have announced plans to start boosting production, a worrisome development for the rest of the world's smelters.

Graph 9 – It is too early to talk about a new trend for industrial metal prices



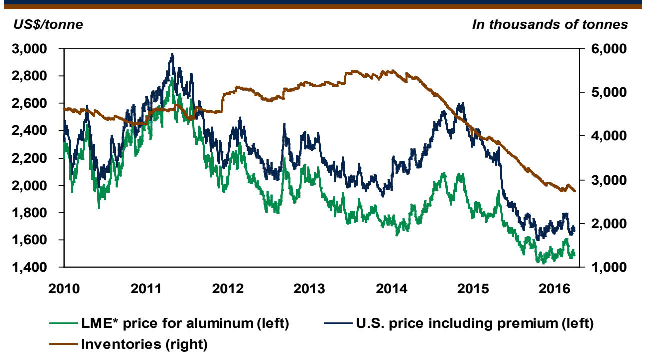
* London Metal Exchange base metals price index.
Sources: Datastream and Desjardins, Economic Studies

Graph 10 – The ISM manufacturing index in the United States has climbed back above the 50 mark



Sources: Institute for Supply Management and Desjardins, Economic Studies

Graph 11 – Aluminum prices and inventories



* London Metal Exchange.
Sources: Datastream, Bloomberg and Desjardins, Economic Studies

COPPER

- Following the general trend, copper prices neared US$5,100 a tonne in early March, then returned to around US$4,700 a tonne (graph 12). The metal's price is still up nearly 4% for the first quarter. Despite the upswing, copper prices remain down about 20% over the last year. The big pullback was primarily due to the fact that a number of analysts expected the copper supply to outstrip demand in 2016. However, the latest forecasts from the International Copper Study Group (ICSG) now call for the market to be balanced this year, despite very modest demand growth. Prompted by the drop in prices, production cuts in the Democratic Republic of Congo and Chile, among others, should be enough to keep the supply from exceeding demand for copper.

NICKEL

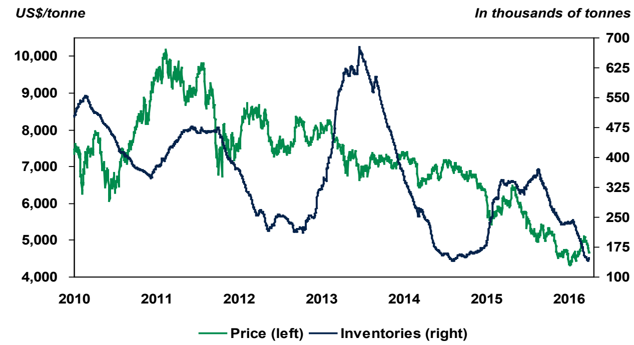
- As in 2015, the start of 2016 was especially hard for nickel: prices fell close to US$7,560 in mid-February to set a 13-year low. Prices then quickly rebounded, going above US$9,350 a tonne at the start of March. This trend did not last; nickel prices recently dropped to around US$8,500 a tonne (graph 13), down from where they were at the end of 2015. One of nickel's problems is that producers have been very reticent to cut production, preferring instead to rely on the drop in energy costs and currency movements to try to stay in the black. However, a drop in production seems increasingly inevitable, particularly in China, which should take the global nickel market into a deficit for 2016 as a whole. Extremely large global inventories could limit the comeback by nickel prices, however.

ZINC

- Zinc is still doing much better than the other industrial metals. Its price went up 13.5% in the first quarter of 2016, recently hitting US$1,870 a tonne, a peak that dates back to last August (graph 14). Unlike what we are seeing for nickel, zinc producers did not hesitate to slash output in the face of last year's price collapse. In a context of favourable demand, therefore, zinc's solid performance is not surprising.

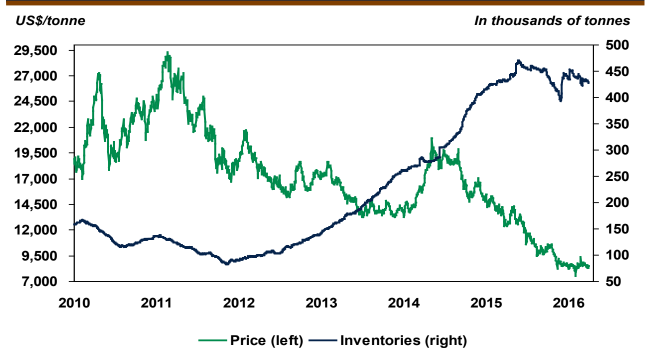
Forecasts: For now, everything suggests global growth will be modest again this year. No surge by demand or industrial metal prices is thus anticipated. Nonetheless, some promising developments in China and the manufacturing sector, along with production cuts, suggest we can hope for some price increase in 2016 after last year's spectacular plunge. Over the medium term, metals with a limited supply, particularly copper, have greater potential to rise than metals like aluminium and iron, where production capacity that became unprofitable as a result of the drop in prices could come back on line quite quickly once the context is better.

Graph 12 – Copper prices and inventories



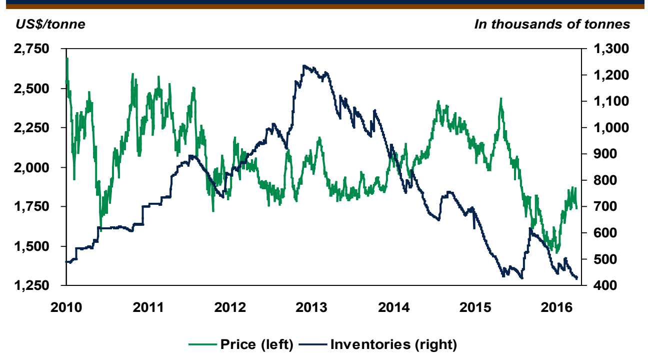
Sources: Datastream and Desjardins, Economic Studies

Graph 13 – Nickel prices and inventories



Sources: Datastream and Desjardins, Economic Studies

Graph 14 – Zinc prices and inventories



Sources: Datastream and Desjardins, Economic Studies

PRECIOUS METALS

Thanks to the central banks

Precious metal prices have really stolen the show since the beginning of 2016. The focus was on the 16% increase in gold prices, the biggest one-quarter advance in 30 years, but silver and platinum also posted a remarkable quarter.

GOLD AND SILVER

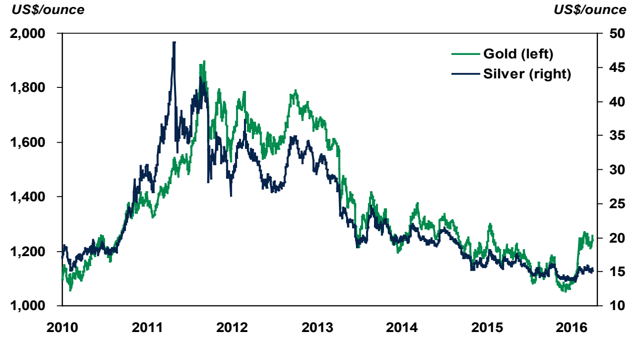
- Despite the renewed investor confidence and stock market advance since mid-February, gold prices have kept rising, hitting US$1,271 an ounce in early March. Gold prices have come down somewhat since then, ending March at US$1,234 an ounce, but still posting an outstanding quarter, like silver (graph 15). If gold prices remain high even though the markets have calmed down somewhat, it is because everything suggests that monetary policies will be even more accommodative than anticipated before. Note that the Bank of Japan decided to try experimenting with negative rates as well, and that very aggressive measures from the European Central Bank suggest that European yields will be very low or negative for several more quarters. Even the Federal Reserve (Fed) is being very hesitant to move ahead with monetary firming (graph 16). Ongoing rates this low is excellent news for gold, since it almost completely eliminates the opportunity cost involved in holding this asset. In a context in which many experts and even some central banks are going so far as to consider printing money to give the economy direct stimulus, we can also see why some investors find gold attractive as a hedge against a generalized drop in currency values.

PLATINUM AND PALLADIUM

- The financial factors that favoured gold and silver also prompted a substantial rise in platinum and palladium prices (graph 17). Recent signs that manufacturing is improving in a number of countries and fairly robust demand for motor vehicles around the world are also encouraging for demand for these two metals.

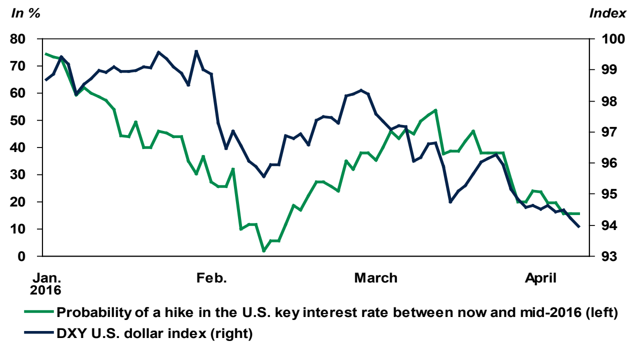
Forecasts: We have raised our targets for gold prices slightly to reflect the aggressive actions being taken by central banks, which will limit the rise of interest rates. The market's reaction to the Fed's recent statements seems exaggerated, however. The U.S. economic situation remains fairly good and a second key rate increase could come as early as June. This should put the U.S. dollar on an upward path and take gold prices to around US$1,100 an ounce by the end of 2016.

Graph 15 – Prices of gold and silver



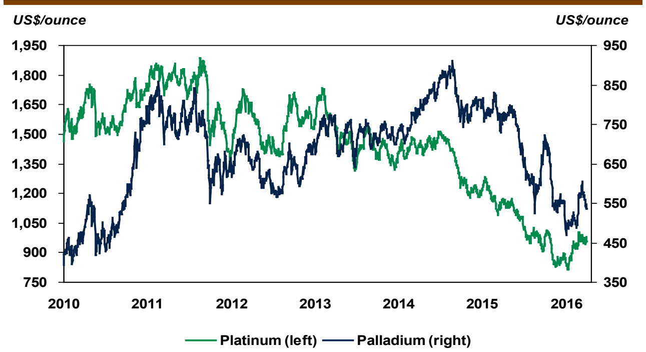
Sources: Datastream and Desjardins, Economic Studies

Graph 16 – The downwards revision to expectations surrounding U.S. key interest rates did damage to the greenback and favoured gold



Sources: Bloomberg and Desjardins, Economic Studies

Graph 17 – Prices of platinum and palladium



Sources: Datastream and Desjardins, Economic Studies

OTHER COMMODITIES

U.S. farmers are turning to corn

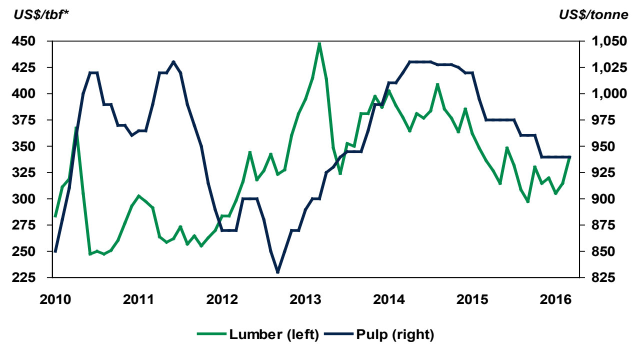
FOREST PRODUCTS

- After plunging in 2015 and getting 2016 off to a difficult start, the benchmark price for U.S. lumber rebounded in the last few weeks, ending the first quarter of 2016 at US$340/tbf (thousand board feet) (graph 18). March's positive meeting between Prime Minister Trudeau and President Obama seems to have had a hand in the upswing. For some, the good relationship between the two leaders improves the chances of another lumber agreement. Such an agreement could buoy wood prices in the U.S. market by limiting or taxing Canadian imports. Note that, since the previous accord ended last October, the North American market has been in a free trade situation, something that is not expected to last long. Favourable seasonal factors and slightly stronger data on housing starts also had a hand in the recent upswing in wood prices. **Wood prices could now consolidate their recent gains.**

AGRICULTURAL COMMODITIES

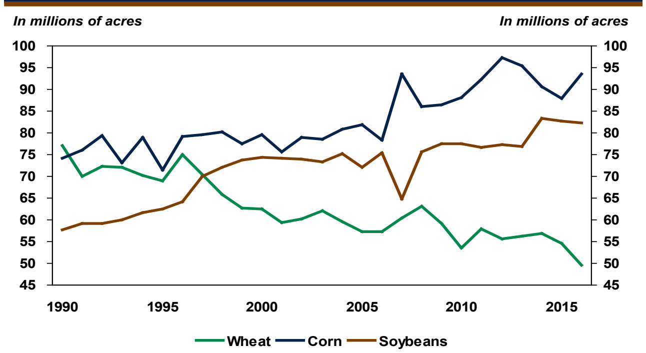
- Wheat prices jumped nearly 15% in the first quarter, contrasting with the 2% pullback by corn prices. For their part, soybean prices gained just over 3%. Cereal price movements are a lot more similar over 12 months, with drops ranging from 4.5% to 7.3%.
- The publication of U.S. farmers' planting intentions at the end of March magnified the retreat by corn prices. Beating all of the analysts' forecasts, the U.S. Department of Agriculture's estimates point to a 6% increase in corn acreage this year. Conversely, the acreage dedicated to wheat should shrink 9% from last year, while soybeans are expected to be almost stable (graph 19). U.S. cereal stock evolution could partly explain farmers' decision. Corn stocks advanced by just 1% in the 12 months ending March 31, 2016, while wheat and soybean stocks jumped by 20% and 15% respectively (graph 20). U.S. wheat exports are not very competitive at the moment, another reason for farmers' decision to turn their backs on this cereal. **Failing inclement weather in the next few months, everything suggests that cereal prices will stay fairly low.**

Graph 18 – Prices of forest products



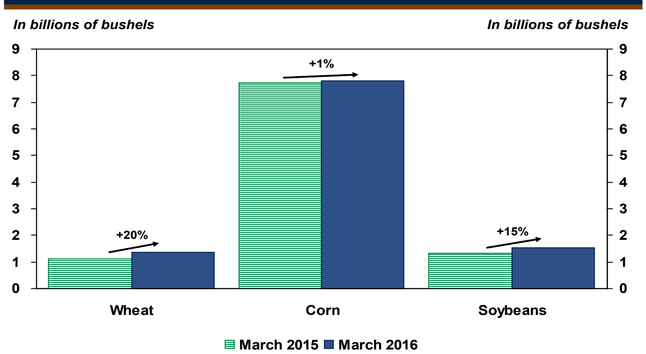
* Thousand board feet.
Sources: Datastream and Desjardins, Economic Studies

Graph 19 – Planted acreages in the United States



Sources: Datastream and Desjardins, Economic Studies

Graph 20 – U.S. cereal stocks



Sources: U.S. Department of Agriculture and Desjardins, Economic Studies

Table 1
Commodities

	Spot price	Percentage return since				Last 52 weeks		
	April 12	1 month	3 months	6 months	1 year	High	Average	Low
Index								
Reuter-CRB[1] (CCI[2])	383.8	-0.5	5.9	-5.3	-8.5	439.0	396.4	353.7
Reuters/Jefferies CRB[1]	171.8	-1.0	6.0	-14.0	-20.9	231.8	193.4	155.0
Bloomberg Commodity Index	79.3	-0.8	6.5	-12.0	-20.3	105.5	87.8	72.9
Bank of Canada	336.7	3.5	5.7	-9.7	-19.5	456.4	371.7	288.1
Energy								
Brent oil (US$/barrel)	43.0	5.9	42.4	-16.4	-24.7	68.2	47.8	27.8
WTI[3] oil (US$/barrel)	40.5	5.1	33.0	-14.1	-21.6	61.4	44.6	26.2
Gasoline (US$/gallon)	2.07	12.4	3.7	-11.5	-14.3	2.84	2.32	1.72
Natural gas (US$/MMBTU[4])	1.88	9.3	-21.0	-23.0	-26.0	3.07	2.37	1.49
Base metals								
LMEX[5]	2,214	-4.9	8.1	-9.3	-20.1	3,003	2,402	2,049
Aluminium (US$/tonne)	1,495	-3.7	3.2	-5.2	-15.6	1,959	1,585	1,426
Copper (US$/tonne)	4,679	-6.2	7.7	-12.2	-22.7	6,482	5,189	4,328
Nickel (US$/tonne)	8,525	-3.1	4.0	-19.7	-32.2	14,318	10,272	7,562
Zinc (US$/tonne)	1,748	-2.8	20.2	-4.0	-20.6	2,434	1,822	1,455
Steel (US$/tonne)	76.0	-0.4	-61.4	-60.7	-74.4	296.5	174.1	75.5
Precious metals								
Gold (US$/ounce)	1,258	-0.1	15.5	8.3	4.2	1,271	1,152	1,052
Silver (US$/ounce)	15.6	0.4	12.1	-2.5	-6.0	17.7	15.2	13.6
Platinum (US$/ounce)	981.0	0.7	16.4	-1.2	-16.2	1,174	978.4	814.0
Palladium (US$/ounce)	547.0	-5.0	16.4	-23.1	-29.6	798.0	621.0	470.0
Other commodities								
Lumber (US$/tbf[6])	347.0	7.8	8.4	13.8	3.3	349.0	321.2	294.0
Pulp (US$/tonne)	940.0	0.0	0.0	-2.1	-3.6	975.0	958.5	940.0
Wheat (US$/bushel)	4.67	-3.5	6.5	5.3	-11.2	5.88	4.63	3.97
Corn (US$/bushel)	3.52	-1.0	0.4	-4.0	-2.2	4.15	3.59	3.36
Soybean (US$/bushel)	8.93	1.7	2.2	3.3	-5.2	10.47	9.07	8.40

[1] Commodity Research Bureau; [2] Continuous Commodity Index; [3] West Texas Intermediate; [4] Million British Thermal Unit; [5] London Metal Exchange Index;
[6] Thousand of board feet.
Note: Currency table base on previous day closure.

Table 2
Commodities prices: history and forecasts

Annual average	2014	2015	2016f	2017f
WTI* oil (US$/barrel)	93	49	Target: 40 (range: 34 to 44)	Target: 52 (range: 40 to 60)
Natural gas Henry Hub (US$/MMBTU**)	4.34	2.65	Target: 2.30 (range: 1.90 to 2.60)	Target: 2.75 (range: 2.25 to 3.50)
Gold (US$/ounce)	1,266	1,160	Target: 1,175 (range: 1,125 to 1,275)	Target: 1,050 (range: 950 to 1,150)
LMEX*** index—base metals	3,117	2,550	Target: 2,300 (range: 2,100 to 2,500)	Target: 2,600 (range: 2,200 to 3,000)

f: forecasts; * West Texas Intermediate; ** Million British Thermal Unit; *** London Metal Exchange Index.
Sources: Datastream and Desjardins, Economic Studies